

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

COMMONWEALTH OF VIRGINIA, ex rel.

STATE CORPORATION COMMISSION

**Ex parte: In the matter concerning
The provision of default service to retail
customers under the provisions of the
Virginia Electric Utility Restructuring Act**

CASE NO. PUE200200645

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**COMMENTS OF THE NATIONAL ENERGY MARKETERS
ASSOCIATION ON COMPONENTS OF DEFAULT SERVICE**

I. Executive Summary

The National Energy Marketers Association (NEM) hereby submits Comments in response to the Order Establishing Investigation of December, 23, 2002, requesting comments on the components of default service in Virginia.

The National Energy Marketers Association (NEM) is a national, non-profit trade association representing wholesale and retail marketers of energy, telecom and financial-related products, services, information and related technologies throughout the United States, Canada and the U.K. NEM's Membership includes wholesale and retail suppliers of electricity and natural gas, independent power producers, suppliers of distributed generation, energy brokers, power traders, and electronic trading exchanges, advanced metering and load management firms, billing and information technology providers, credit, risk management and financial services firms, software developers, clean coal technology firms as well as energy-related telecom, broadband and internet companies.

This regionally diverse, broad-based coalition of energy, financial services and technology firms has come together under NEM's auspices to forge consensus and to help resolve as many issues as possible that would delay competition. NEM members urge lawmakers and regulators to implement:

- Laws and regulations that open markets for natural gas, electricity and related products, services, information and technology in a competitively neutral fashion;
- Rates, tariffs, taxes and operating procedures that unbundle competitive services from monopoly services and encourage true competition on the basis of price, quality of service and provision of value-added services;

- Competitively neutral standards of conduct that protect all market participants;
- Accounting and disclosure standards to promote the proper valuation of energy assets, equity securities and forward energy contracts, including derivatives; and
- Policies that encourage investments in new technologies, including the integration of energy, telecommunications and Internet services to lower the cost of energy and related services.

II. Introduction

As a general matter, NEM submits that in a restructured environment the utilities' historical obligation to serve should be converted into an obligation to connect and deliver. Therefore, while the utilities should and will continue to provide transportation or distribution services for all customers, it is not necessary or desirable to establish the utilities, on a long-term basis at least, as the default provider of energy supply services. These principles are more fully set forth in NEM's, "**National Guidelines for Designing and Pricing Default Energy and Related Services**,"¹ and inform NEM's responses to the questions below.

III. Response to Commission Proposed Issues:

1. What should be the specific components of default service?

The components and pricing of default service are critically important to the development of a competitive market because the default service price serves as the "price to compare" - the target against which all competitive offers are judged by consumers. NEM submits that if the utility acting as default service provider is allowed to subsidize retail energy services by passing through wholesale price signals and embedding the retail costs of energy related services in its distribution rate, the default service price will be an artificially low, subsidized price. If the default service does not reflect the true costs of providing retail generation service, true competition on the basis of price and quality of service will not be possible. Competitive suppliers will be challenged to cover their costs to offer products that provide value to customers. An artificially low, subsidized default service price, not only provides false price signals but establishes a significant barrier to effective price competition by forcing customers who switch to competitive suppliers to pay twice for retail energy services. Under these circumstances fewer customers will choose competitive energy suppliers, the utilities market share will be maintained, consumers will not benefit to the degree they should, and competitive markets will not develop.

The default service price must include the fully allocated embedded costs of energy supply including the commercial costs of supplying retail load. All suppliers providing generation service to customers at retail, including default service and competitive

¹ The full text of NEM's "National Guidelines for Designing and Pricing Default Energy and Related Services," is available at <http://www.energymarketers.com/Documents/FinalDefaultPaper.pdf>.

suppliers, incur costs to do so in addition to the wholesale costs of energy commodity. These costs include: transmission charges, scheduling and control area services, and distribution system line losses, a share of pool operating expenses, risk management premiums, load shape costs, commodity acquisition and portfolio management, working capital, and taxes, administrative and general expenses, the costs of metering, billing, collections, bad debt, information exchange, compliance with consumer protection regulations, and customer care. Accordingly, all of the costs associated with these products and services can and should be included in the cost of providing default services.

2. Whether, given the virtual absence of competition in Virginia's retail generation market, incumbent electric utilities should continue to provide default service at capped rates at the present time; if so, what changes in statute, policy, infrastructure, market conditions, and/or other circumstances are necessary to allow for the practical provision of default service by an entity other than the incumbent.

Utilities should not continue to provide default service at capped or artificially subsidized rates inasmuch as capped rates send distorted and normally cross-subsidized price signals to consumers. The provision of default service by entities other than the utility can occur relatively quickly and efficiently perhaps through an auction process. Marketers have the ability and experience to supply these services to customers. Marketers have long been involved in developing and aggregating generation and providing utilities with energy as a commodity. In many cases, marketers have supplied utilities with energy and related services on an outsourced basis for years, enabling those utilities to provide energy supply services.

If the Commission decides that the utilities should continue to provide default service, the requirements of section 56-585(C)(1) that, "the rates for default service provided by a distributor shall equal the capped rates" until the expiration or termination of capped rates, presents a significant obstacle for the market. As has been evidenced by lackluster customer participation in choice programs in the state, the capped rates instituted for the utilities have stifled competition. Capped rates are set artificially low and competitive suppliers cannot offer competitive products at such rates. Additionally, since capped rates do not change over time to reflect changes in the wholesale market there is tremendous pressure on retail suppliers during times of wholesale price volatility. Default service pricing mechanisms that allow prices to change over time in response to wholesale market conditions better reflect real competitive markets, provide more accurate price signals, and help level the competitive retail playing field.

The provision of default service based on capped or subsidized rates will not foster the development of the competitive market. If the Commission mandates the selection of the incumbent utility for all customers who fail to make timely supplier elections and sets a non-competitive price for default service, it will create a significant barrier to new suppliers while perpetuating the same non-competitive energy services that restructuring is designed to replace.

- 3. What should be the geographic scope of a default service provider's territory, i.e. statewide, incumbent utility service territory, regions served by specific regional transmission entities; divisions with an incumbent utility's service territory; major metropolitan and surrounding areas, etc.;**

It is not necessary to have one supplier provide default service to all customers in the state or of a particular utility. In fact, the default provider could be different by customer group since the cost to provide default service varies by customer group. Properly designed default service prices should reflect these real cost differentials to encourage competition for all customer classes. When suppliers focus their efforts on specific customer classes they can achieve economies of scale that can and should result in lower prices to consumers. Additionally, providing accurate "prices to compare" by customer class will enhance competition as competitive suppliers will not have to cover their costs to compete with artificially low prices.

- 4. Whether default service, as contemplated by § 56-585 of the Act, should be limited to unregulated services, i.e. is it necessary to designate distribution service as a default service;**

It is not necessary to designate distribution service as a default service. Default service, refers in the broadest sense to the service provided to those customers in a competitive market who are not receiving energy supply services from a competitive supplier for any number of reasons. Section 56-585 similarly defines default service as service for those without an alternative supplier. In the newly deregulated market place, utilities will continue their natural monopoly functions, i.e. distribution, and their obligation to serve should be transformed into an obligation to connect and deliver. There is no reason to designate distribution service as a default service since there are no alternative distributors for customers to choose from.

Customers should be indifferent to the rates they pay for distribution service, whether they are default service customers, are served under a utility's bundled sales tariff, or by a competitive supplier. Consequently, distribution service charges should be a separately set forth charge to permit customers to then compare the costs of shopping for competitively-provided energy and energy-related products, services, information and technologies.

- 5. For generation-related default service, whether the separate components of generation service to retail customers (capacity or resource reservation, energy, transmission, and ancillary services) should be treated as separate default services or bundled into a single service;**

For generation-related default service, the separate components of generation service to retail customers should be unbundled and treated as separate default services. Unbundled services and the accompanying unbundled rates expose consumers to price signals to permit them to compare competitive options. Providing more competitive options will maximize the benefits of innovation, reduce prices and provide higher quality service, while minimizing the economic distortions inherent in bundled prices.

6. For generation-related default service, whether the service should be delivered to the retail customer or the incumbent utility;

For generation-related default service, the service should be delivered directly to the retail customer. If generation related default service is delivered to the incumbent utility, NEM submits that it will not contribute to the ultimate development of a competitive retail market because customers will be unaware of the competitive suppliers serving their supply needs. The competitive suppliers will have no direct conduit with customers and will not be able to establish themselves in customers' perception as reliable, low cost suppliers. Without consumer confidence in retail suppliers migration rates will remain stagnant. Additionally, Customers will not be receiving default service on a truly competitive basis because the utility will still be acting as an intermediary point of contact for supply. In the long term, competitive suppliers must be able to render default service at the retail level.

7. Whether the language of the statute prohibits the provision of default service to an incumbent utility on behalf of a group of customers, i.e. could a third party provide service to an incumbent utility for indirect service to retail customers (service to satisfy load growth, specific localities, or to customer subgroups);

NEM strongly urges this Commission not to interpret competitive provision of default service to mean competitive wholesale provision of supply to utilities for their retail customers. Section 56-585(A) defines "default service" as, "service made available under this section to retail customers." (emphasis added). The specific inclusion of the words "to retail customers" in the Code means that competitive suppliers are to provide default service directly to retail customers, not on a wholesale basis to the utility as an intermediary. Additionally, see NEM's answer to Question 6.

8. Whether the provision of default service should differ by customer class;

NEM submits that Section 56-585(B)(2) of the Code properly permits competitive bidding for different suppliers of, "one or more components of such services, in one or more regions of the Commonwealth, to one or more classes of customers." The costs to provide default service vary by customer group. As permitted and recognized by the Code, properly designed default service prices should reflect these real cost differentials to encourage meaningful price competition for all customer classes. See also NEM's answer to Question 3.

9. Whether different components of default services can be provided by different suppliers;

If the components of default service are properly and fully unbundled and competitively let it will permit different competitive suppliers to make offerings. For instance, different providers of metering services, billing services, and generation-related services could provide these components. Unbundled services and the accompanying unbundled rates will expose consumers to price signals and permit them to compare competitive options. Additionally, suppliers will be attracted to the Virginia market if they can compete successfully with default service on the basis of price for a myriad of products and

services. Customers, in turn, will be more inclined to select a competitive supplier when there are many suppliers in the market advertising and offering a variety of products and services for sale.

10. Whether default service has the same meaning for different classes of customers, those who do not affirmatively select a supplier, those who are unable to obtain service from an alternative supplier, or those who have contracted with an alternative supplier who fails to perform;

NEM submits that default service should be defined as the service provided to those customers in a competitive market who are not receiving energy supply services from a competitive supplier for any number of reasons.

In part, Question 10 addresses the issue of how to meet the needs of low income customers in a competitive marketplace. NEM urges that specific programs be designed to address low-income customers rather than trying to utilize default service for this purpose. Often, concerns that low-income individuals will be unwelcome in the competitive market drives, explicitly or implicitly, the design and pricing of default service. This approach serves neither low-income customers nor the development of a competitive market well. Specific programs should be designed to serve low-income needs and to facilitate the targeting of public benefit funds. Such programs might include aggregation of low-income customers to access lower prices in the competitive market, perhaps with subsidies or guarantees of payment that would ensure the lowest-cost supply for these customers. Alternatively, such funds may follow the customer and lower the anticipated collection costs associated with certain customers, thereby lowering the cost to serve such customers and permitting suppliers to lower prices.

11. How should charges for default service be collected;

The charges for default service should be unbundled to reflect the prices of the underlying service components as discussed in NEM's answer to Question 1. If the Commission determines that default service should be rendered by the utility, these components should be properly priced at the utilities' fully allocated embedded costs for each component.

12. Whether metering, billing and collecting services should be deemed components of default service;

Yes, metering, billing and collecting services should be deemed components of default service and they should be separately priced for consumers to understand the costs of these services. See also NEM's answer to Question 1.

13. What implications would the alternative provision of default service have for the determination of the wires charges?

The alternative provision of default service could impact the determination of the wires charge but only if the utility is shown, in fact, to have net stranded costs that justify collection of a wires charge.

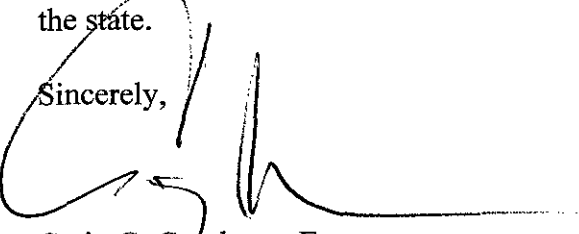
NEM urges the Commission to ensure that any costs that are unavoidable because utilities must incur such costs to perform default service be recovered through adjustments to the rates charged for default service. Utilities should not be permitted to recover revenue shortfalls based on a formula that assumes all unavoidable costs are caused by migration rather than by the necessity to provide default service.

Providing revenue recovery based on estimates of migration and the assumption that migration itself rather than the cost of default service causes the revenue shortfall will under-price default service and unfairly penalize customers who migrate. Any determination of costs that are truly stranded must necessarily address the issue of whether the "unavoidable" costs at issue are, in fact, costs properly attributable to default service.

IV. Conclusion

NEM appreciates this opportunity to comment on the components of default service in Virginia and reiterates our commitment to working with the Commission and the other stakeholders to devise fair and effective ways to implement competitive restructuring in the state.

Sincerely,



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